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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 144.

WILLIAM CARNEGIE EWEN, *et al.*,
Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY,
Respondent.

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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Statement.

Petitioners herein are members of a committee, styled Income Bondholders Protective Committee, representing certain of the holders of the Income Bonds of The Peoria and Eastern Railway Company and their counsel.

Petitioners' application for allowances, the denial of which is now sought to be reviewed, was made in a proceeding under Chapter XV, originally numbered as Sections 700 to 755, of the Bankruptcy Act (Title 11, U. S. Code, Sections 1200-1255).* By Section 1200, the Bank-

* NOTE: The references to sections herein are in accordance with the numbering contained in Titie 11, U. S. Code.

ruptcy Court was authorized to exercise original jurisdiction as provided in said Chapter XV for "postponements or modifications of debt, interest, rent, and maturities or for modifications of the securities or capital structures of railroads." As provided in Section 1255, the jurisdiction conferred by Chapter XV terminated on July 31, 1940, except as to proceedings pending at that time.

The Peoria and Eastern brought proceedings pursuant to such Chapter XV in January of 1940 for the approval of a Plan of Adjustment in respect of its Consolidated Bonds, which Plan had been assented to as provided in such Chapter and was, following approval thereof by the Interstate Commerce Commission pursuant to Section 1210, approved on June 29, 1940, by the Special Court convened pursuant to Section 1213. The petitioners had opposed approval of the Plan. The opinion of the Court approving the Plan is reported in 34 Fed. Supp. 332, and applications for certiorari by petitioners and a committee representing certain minority Consolidated Bondholders were denied (311 U. S. 700).

Thereafter, petitioners herein and the minority committee of the Consolidated Bondholders applied for allowances. Such applications were denied by the Special Court on April 3, 1941, in an opinion by Judge Woolsey (Record, pp. 10-17; reported 37 Fed. Supp. 917). Application for reargument by petitioners herein (in which the committee of Consolidated Bondholders did not join) was denied in a memorandum by the Special Court under date of April 18, 1941 (Rec., p. 36). The committee of Consolidated Bondholders has not joined in the pending petition for certiorari.

The Special Court in its opinion (34 Fed. Supp. 332, 338) had required that the Plan be modified so as to provide that the Income Bondholders should have one director upon the

Board of the Peoria and Eastern. The claim of petitioners for an allowance is largely based upon this modification which the Court held did not substantially affect the rights of any class of creditors and did not require resubmission to the Interstate Commerce Commission or security holders.

Petitioners' contention (petition, p. 3), that recital in the supplemental decree with reference to indebtedness of the Peoria and Eastern to the New York Central was a modification of the Plan insisted on by petitioners, is misleading. That the accounts in question were wholly unrelated to the Plan and that the Special Court made no disposition of such accounts appears from the opinion of Judge Learned Hand (34 Fed. Supp. 332, 336), as follows:

> "The Accounts between the New York Central and the Peoria & Eastern.
>
> "Not only has a large operating deficit accumulated against the Peoria & Eastern, but a large 'retirement' account and a large 'depreciation' account have accumulated in its favor against the New York Central. The plan does not liquidate either of these, and the order of confirmation will leave open all questions touching their amount and validity. If the New York Central seeks in any year to withdraw any part of the earnings by way of recoupment, it must prove its right. All we now hold is that the covenant to maintain the road and to make additions to its equipment, did not contemplate gratuitous advances, and that the third article allowed recoupment for so much as was properly expended. Whether the cross items can be offset, the plan also leaves open."

Petitioners' Application for Allowances Was Properly Denied.

The matter of allowances under Chapter XV of the Bankruptcy Act has been considered by Special Courts convened in three cases, the *Baltimore and Ohio Case,* the *Lehigh Valley Case* and the instant case. In each, the Court found that under the terms of said Chapter it has no jurisdiction to grant allowances.

In re Baltimore & O. R. Co., 34 Fed. Supp. 154, 160, District Judge Chesnut, writing for the three-judge Court consisting of Circuit Judges Parker and Dobie and himself, said:

> "(4) Counsel for certain security holders allowed to intervene in this case, who personally participated in the hearings, have asked the court for allowances for fees for their services, to be paid by the B and O. These counsel represented the holders of securities of several issues in the amount of about $50,000. The general position of some of them was not nominally opposed to the Plan as a whole, but to obtain modifications of the Plan in certain respects for the benefit and advantage of their respective clients. Nevertheless the general effect of the success of the opposition by all of them would practically have been to defeat the Plan. *The court was very glad to have these counsel participate in the case and to hear and consider their arguments. They were helpful in an understanding of the issues involved and clarifying the questions debated, and to some extent in criticizing and suggesting changes in the supplemental indenture and modifying agreements.* We are, however, of the opinion that we have no authority under the Act to make the allowances. The nature of the case is not one where a court of equity has general jurisdiction over a fund in court, with incidental

> power to make allowances out of the fund to counsel or parties who have performed services to bring the fund into court or to preserve it. The provision of the Act in section 1225 (6) with regard to approval of expenditures of the petitioners including legal expenses is the only reference to the subject in the whole Act. The legislative history of the passage of the Act referred to by counsel affords no indication that it was the intention of Congress to authorize the court exercising the special jurisdiction in this case to make such allowances to counsel for security holders appearing in opposition to the Plan, or seeking modifications of it. In this respect the Act is quite different from former Section 77B and the present Chapter 10 of the Bankruptcy Act. We are unable, therefore, to make the allowances requested." (Italics ours.)

Certiorari was denied, 311 U. S. 717.

In the *Lehigh Valley Railroad Company Case,* before a Special Court consisting of Circuit Judge Maris and District Judges Welsh and Kalodner, a similar application by intervenors in that case was denied in an order entered on October 21, 1940, reading as follows:

> "The petitions of Meyer Abrams, Samuel Paul Puner, Isadore H. Schweidel, Cecil M. Page, Stewart M. Seymour, and Edith A. Merrit for the allowance or approval of fees or compensation for services and reimbursement of expenses not authorized by the petitioners are dismissed for want of jurisdiction in this court to entertain them (See in re *Baltimore & O. R. Co.,* 34 F. Supp. 154)."

Certiorari was denied February 3, 1941 (85 L. Ed. 492).

In the instant case, the opinion (Rec., pp. 16-17) of Judge Woolsey (concurred in by the other two members of the special bench, to wit, Circuit Judge Learned Hand and

District Judge Hulbert) points out the dissimilarity, as to allowances, between Chapter XV of the Bankruptcy Act, dealing with Adjustments, and Section 205 of the Bankruptcy Act, covering Railroad Reorganizations.

The reason for the distinction, with respect to allowances, between Chapter XV and the other chapters of the Bankruptcy Act dealing with railroad and non-railroad reorganizations, referred to as Sections 77 (now Section 205, U. S. Code) and 77B (now Sections 501 *et seq.*, U. S. Code), is clear. In proceedings under Sections 77 and 77B the Court takes charge of the property and administers it. It assumes complete possession, which is exercised through its appointees, so that it has a fund in its custody that becomes subject to its disposition, as is the familiar situation in equity. Here, however, the Court does not have custody and possession of the estate, and its only jurisdiction with respect to the property of the Railway Company is the jurisdiction provided in Section 1215, empowering it during the pendency of the proceedings to protect the Railway Company and its property

> "against any action which might be inconsistent with said plan of adjustment or might interfere with the effective execution of said plan if approved by the court, or otherwise inconsistent with or contrary to the purposes and provisions of this chapter: *Provided, however,* That nothing herein contained shall be construed to authorize the court to appoint any trustee or receiver for said properties or any part thereof, or otherwise take possession of such properties or control the operation or administration thereof."

Notwithstanding the complete absence of any provision of the statute authorizing the making of allowances, petitioners argue that Section 1213, by implication, invests the

Court with necessary power. Apparently petitioners construe the provision in question as if the latter part thereof, italicized in the following quotation, did not exist, to wit:

> "Such three-judge court shall be vested with and shall exercise all the powers of a district court sitting in equity and all the powers as a court of bankruptcy *necessary to carry out the intent and provisions of this chapter, including the classification of claims at such time and in such manner as the court may direct.*"

The matter of fees and expenses is specifically covered in subdivision (6) of Section 1225, as follows:

> "(6) That, after hearings for the purpose, all amounts or considerations, directly or indirectly paid or to be paid by or for the petitioner [the Railway Company] for expenses, fees, reimbursement or compensation of any character whatsoever incurred in connection with the proceeding and plan, or preliminary thereto or in aid thereof, together with all the facts and circumstances relating to the incurring thereof, have been fully disclosed to the Court so far as such amounts or considerations can be ascertained at the time of such hearings, that all such amounts or consideration are fair and reasonable, and to the extent that any such amounts or considerations are not then ascertainable, the same are to be so disclosed to the Court when ascertained, and are to be subject to approval by the special court as fair and reasonable, and except with such approval no amounts or considerations covered by this clause (6) shall be paid."

Chapter XV is the part of the Bankruptcy Act dealing exclusively and comprehensively with *adjustments,* as distinguished from *reorganizations,* which are governed by other provisions of the Act. Since Chapter XV carries its own provision, above-quoted, governing allowances, it

seems manifest that such provision was intended to be exclusive as to adjustments under that Chapter. The obvious contemplation of Chapter XV was that intervenors should bear their own law expenses, or if employed by others should, as is the usual situation, look to them for their fees.

Furthermore, petitioners in the instant case were not even *affected* by the Plan of Adjustment approved by the Court. Sections 1210 and 1225 provide for assents by specified percentages of all claims *affected* by the Plan as conditions to (1) submission to the Interstate Commerce Commission, (2) filing of the Plan in Court, and (3) approval by the Court.

The Court in its findings in respect of the Plan (Rec., pp. 25-26) found that the only claims *affected* by the Plan were the First Consolidated Bonds; that consents of the Income Bondholders to the Plan had not been solicited or secured; that the Plan had been accepted by more than the required percentage of First Consolidated Bonds; and that the Plan had been accepted in accordance with Chapter XV of the Bankruptcy Act. The petitioners were authorized to intervene as persons in interest under Section 1220, not as parties *affected* by the Plan. The Court in the instant case, as in the *Baltimore and Ohio Case*, welcomed the participation of the intervenors and considered it helpful.

Indeed, it would appear that the petitioners, who have been held not to be *affected* by the Plan, are without legal authority to apply for certiorari. Section 1245, which is the only jurisdictional authority invoked by petitioners (their petition, p. 4), reads as follows:

> "Any final order or decree of the special court may be reviewed by the Supreme Court of the United States upon application for certiorari made by any person *affected by the plan* who deems himself

aggrieved within sixty days after the entry of such order or decree, pursuant to the provisions of the Federal Judicial Code." (Italics ours.)

Furthermore, since Chapter XV lapsed by its own limitation (Section 1255) as of July 31, 1940, with the exception of any cases then pending (and so far as we know the Peoria and Eastern was the last), the pending question is moot except as to the immediate parties. As shown above, Special Courts in two separate circuits, in addition to the Special Court in the instant case, have ruled adversely to the construction of the Adjustment statute now urged by petitioners. The Supreme Court denied certiorari in both cases, the application in the *Lehigh Valley Case* relating solely to the question of allowances.

Accordingly, it is submitted that the order below was right, that the issue is no longer an open one and that in no aspect are any questions involved which warrant review.

Respectfully submitted,

JACOB ARONSON,
CROSBY J. BEAKES,
JOHN PURYEAR,
Counsel for Respondent.

July 1, 1941.

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Petitioners,

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Respondent.

REPLY MEMORANDUM OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

CHARLES S. ARONSTAM,
Counsel for Petitioners.

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REPLY MEMORANDUM OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Although counsel for the New York Central Railroad Company, who are also counsel for the respondent, attempt, at the outset of their brief, to minimize the services rendered herein by petitioners, the opinion of the Special Court speaks for itself:

> "that by the modifications in the plan which they suggested, in our opinion, they made a valuable contribution to the creation of a fair and reasonable adjustment herein under which the parties will have to operate for

> many years to come, and that *if we felt that we were authorized by Chapter 15 of the National Bankruptcy Act to grant them or their counsel a reasonable allowance, we should have done so*" (Record, p. 17). (Italics ours.)

Petitioners are entitled to be compensated for their services in accordance with the established principles of equity as enunciated in *Trustees* v. *Greenough*, 105 U. S. 527, and *Sprague* v. *Ticonic Bank*, 307 U. S. 161.

In *Trustees* v. *Greenough, supra,* the Court said:

> "It is a general principle that a trust estate must bear the expenses of its administration" (at p. 532).

In *Sprague* v. *Ticonic Bank,** *supra,* plaintiff instituted suit on her own behalf to affix a lien on earmarked funds in an insolvent bank for the repayment in full of a sum theretofore deposited by her in trust. After establishing her lien, plaintiff petitioned the District Court for reasonable counsel fees and litigation costs to be paid out of fourteen trusts in situations similar to her own, contending that by reason of her efforts, she established, as a matter of law, their right to recovery in the same manner as her own right. The District Court denied the petition on the ground that it did not have the power to grant such an allowance. Mr. Justice Frankfurter, in upholding the right of plaintiff to the allowances prayed for, said:

> "Allowance of such costs in appropriate situations is part of the historic equity jurisdiction of the federal courts" (at p. 164).
>
> "That the party in a situation like the present neither purported to sue for a class nor formally established by litigation a fund available to the class, does not seem to be a differentiating factor so far as it affects the

* The opinion in this case supports the contention of petitioners that it is not necessary for a fund to be in court for equity to grant an allowance where necessary and beneficial services have been rendered to a trust estate.

source of the recognized power of equity to grant reimbursements of the kind for which the petitioner in this case appealed to the chancellor's discretion. *Plainly the foundation for the historic practice of granting reimbursement for the costs of litigation other than the conventional taxable costs is part of the original authority of the chancellor to do equity in a particular situation*" (at p. 166). (Italics ours.)

"As in much else that pertains to equitable jurisdiction, individualization in the exercise of a discretionary power will alone retain equity as a living system and save it from sterility. In the actual exercise of the power to award costs 'as between solicitor and client' all sorts of practical distinctions have been taken in distributing the costs of the burden of the litigation" (at p. 167).

The Special Court held that it was precluded from awarding any allowances except as approved by the respondent by reason of the provisions of Section 725(6) of Chapter XV (11 U. S. C. A. 1225(6)). Section 725(6) was inserted in Chapter XV for the sole purpose of having the Special Court control and police the expenses incurred by the debtor railroad in connection with the consummation of a plan of adjustment. As stated by Judge Chestnut in *In re Baltimore & Ohio R.R. Co.*, 34 Fed. Supp. 154, this provision was for the protection of security holders so that "funds which might otherwise be applicable to payment on their securities, shall not be wasted or lavishly disbursed for purposes or in amounts other than are reasonably and properly necessary for successful prosecution of the Plan."

If the sole purpose of Section 725(6) was for the protection of security holders, Congress could not have intended thereby to preclude the Special Court from awarding compensation to intervenors in cases where their services were necessary and beneficial to the security holders.

The Report of the Senate Committee on Interstate Commerce (Report No. 489, 76th Congress, First Session) states,

among other things, the purpose of this legislation as follows:

> "(3) to safeguard the public interest and the interest of investors in any application of the bill if enacted."

In the case at bar the only way the Income Bondholders as a class could be protected was by the independent intervention of the petitioners.

In the light of the foregoing it is respectfully submitted that Section 725(6) does not preclude the Special Court from exercising its equity power, as set forth in Section 713 (11 U. S. C. A. 1213), to award petitioners compensation for their valuable services herein. It would require unequivocal language to compel the conclusion that Congress intended, in proceedings under Chapter XV, to preclude the Special Court sitting as a court of equity from exercising its historic right to award allowances to those who aid in the administration of a trust estate.

Respondent initiated these proceedings solely for its own benefit. The Income Bondholders were forced to intervene to protect their interests and the respondent, in equity and good conscience, should bear the expenses incident thereto.

The principle enunciated in *In re Watco Corporation,* 95 F. (2d) 249, is applicable to the facts herein. In that case the Court said:

> "* * * it is as important that fees for meritorious services actually rendered and necessary to effectuate a reorganization should be allowed as it is that the court should prevent the undue enrichment of attorneys for services of no value to the debtor" (at p. 251).

Respondent asserts in its brief that, under Section 745 of Chapter XV (11 U. S. C. A. 1245) the petitioners are without legal authority to petition this Court for a writ of certiorari, on the ground that the Income Bondholders were not affected by the Plan. There can be no doubt that the Income Bondholders were adversely affected by the terms and provisions of the Plan of Adjustment as promulgated

by the respondent, as evidenced by the modifications to the Plan made by the Special Court at the instance and request of the petitioners who represented the Income Bondholders as a class.

The realistic and equitable approach to the matter of compensation as presented herein is embodied in the opinions of Judge Cardozo in *Schoenherr* v. *Van Meter,* 215 N. Y. 548, 552; Mr. Justice Frankfurter in *Sprague* v. *Ticonic National Bank,* 307 U. S. 161, 164, 166, 167, and Mr. Justice Hughes in *Reconstruction Finance Corporation* v. *J. G. Menihan Corporation et al.,* 85 Law. Ed. 458, 460. In each of these cases the Court brushed aside technicalities to the end that justice might be done to those who rendered beneficial services to a trust estate.

It is apparent that the order of the Special Court denying compensation to the petitioners on jurisdictional grounds, despite the fact that the Court recognized that the services rendered were valuable and necessary, creates an unjust and harsh result.

The Committee and its counsel have labored unremittingly in excess of one year in their efforts to safeguard the interests of the Income Bondholders and respondent itself: and in that they have been successful. The order of the Special Court denying compensation to petitioners has so far departed from sound equitable principles as enunciated by this Court as to call for the exercise of this Court's power of supervision to the end that justice may be served.

Respectfully submitted,

CHARLES S. ARONSTAM,
Counsel for Petitioners.

July 17, 1941.